

**Statement by Hon. John J. LaFalce before the Capital Markets
Subcommittee on the Enron Bankruptcy**

February 4, 2002

Since this Committee assumed jurisdiction over capital markets issues, I have warned that earnings manipulation and deceptive accounting threatened the very integrity of our capital markets, and in early 2001 began calling for a significant increase in the SEC's budget to strengthen its personnel, oversight, and enforcement. Enron's colossal failure and its devastating impact on investors and on the working men and women at Enron have more than justified those concerns.

Today we will hear what went wrong at Enron and how a culture of corporate arrogance and greed resulted in losses of over \$60 billion to investors and employees. The Special Investigative Committee's Report is a devastating indictment of Enron's senior management, its board of directors, its auditors, and its lawyers, all of whom failed to fulfill their responsibilities to Enron's shareholders. The safeguards that should have protected investors failed at every level.

The failure of Enron has challenged investors' faith in the integrity of the capital markets. We must address the systemic problems that Enron's failure has made all too apparent if we are to prevent future Enrons, restore the faith of investors in our capital markets, and restore the faith of workers in their employers. To do so, we must engage in a collective rethinking and reformulation of how we oversee our capital markets and our financial disclosure system. We must also give the SEC the resources it needs to do its job. I was extremely disappointed to learn that the Administration has not seen fit to provide the SEC with any increase in resources to address these challenges, or even to fund pay parity for SEC employees.

I believe that the Committee should proceed deliberatively and on the basis of a thorough and thoughtful record to identify real solutions to these problems. I have been engaged in productive bi-partisan discussions with both Mr. Oxley and Mr. Baker to attempt to craft legislation to deal with the serious policy issues Enron and cases like it raise. I am hopeful that we will be able to agree on a set of tough and serious proposals to address these issues. At a minimum, I believe we must address the following areas:

- We must seriously consider the separation of audit and consulting functions to ensure that auditor judgement is not tainted by the fees received for non-audit services. An auditor's first duty should be to the

public, and the public is being ill-served by the current performance of this profession. Data now available under the SEC's disclosure rule on non-audit fees makes clear that, for the auditors of many large public companies, audit fees are a minute percentage of the fees they receive. Even in the absence of Enron, that data alone justifies a re-examination. I fully support the recommendations of previous SEC Chairman Levitt in this area. We also should consider other proposals to improve auditor independence, such as term limits for auditors.

- Exclusive self-regulation has brought us to where we are today and cannot work in and of itself. We need significantly enhanced public oversight and regulation of the auditing and securities industry, including a strong new auditing regulator with a full range of powers.
- We must find a way to provide a massive increase in SEC resources to provide more regular and systematic oversight by the SEC of the disclosure of public companies.
- Financial reporting for public companies must be substantially strengthened to confront misleading and fraudulent accounting practices that have resulted in billions of dollars of losses to investors.
- The functioning of audit committees and the boards of directors of public companies must be reformed to ensure that independent directors are truly independent and that auditors are working for shareholders, not management.
- We must require real-time disclosure of insider stock sales, so that investors know when insiders are getting out.

While the reforms needed are not without cost, they are far less costly than the losses to investors and our economy of continued financial scandals and failures. Earlier this year, I said that the record number of earnings restatements mandated by the SEC were the "tip of the iceberg." Even as we deliberate, more companies may be forced to restate their financial results because of misleading or fraudulent accounting. We must use this opportunity to restore the accuracy and integrity of financial reporting to ensure that "the next Enron" gets cleaned up before it's too late.